

HOUSE FINANCE COMMITTEE

April 6, 2012

9:46 a.m.

9:46:27 AM

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 9:46 a.m.

MEMBERS PRESENT

Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Co-Chair
Representative Anna Fairclough, Vice-Chair
Representative Mia Costello
Representative Mike Doogan
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Reggie Joule
Representative Mark Neuman
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Representative Steve Thompson, Sponsor; Jane Pierson, Staff, Representative Thompson; Susan Pollard, Assistant Attorney General, Department of Law.

PRESENT VIA TELECONFERENCE

Elizabeth Hensley, NANA Regional Corporation; Lance Miller, Vice President Resources, NANA Regional Corporation; James Mery, Senior Vice President, Lands and Natural Resources, Doyon LTD; Bob Swenson, State Geologist, Department of Natural Resources.

SUMMARY

HB 276 OIL/GAS PRODUCTION TAX CREDITS: NENANA

HB 276 was HEARD and HELD in Committee for further consideration.

#hb276

HOUSE BILL NO. 276

"An Act providing for a credit against the oil and gas production tax for costs incurred in drilling certain oil or natural gas exploration wells in the Nenana Basin."

[9:47:29 AM](#)

Vice-chair Fairclough MOVED to ADOPT proposed committee substitute, work draft 27-LS1193\G, (Nauman/Bullock, 3/27/12).

Co-Chair Stoltze OBJECTED for the purpose of discussion.

REPRESENTATIVE STEVE THOMPSON, SPONSOR, spoke in support of the proposed committee substitute (CS). He observed that the bill was originally conceived to provide tax credits that were meaningful enough to attract exploration in the Nenana Basin in order to alleviate the staggering energy costs in Fairbanks. He observed that \$660 million was spent last year for space heating with an average kilowatt per hour cost of 23 cents. Heating oil was over \$4.00 per gallon and natural gas was at \$23 per thousand cubic feet (Mcf) and only available to 1,100 customers due to shortages of supplies.

Representative Thompson observed that many people were burning wood or coal due to the high costs of energy, which was not helping Fairbanks meet the Environmental Protection Agency's (EPA) [air quality] standards of 2.5 parts per million. He asserted that some residents had to choose between paying for necessities or keeping warm during the winter.

Representative Thompson stressed that the lack of adequate gas supplies had also created a stumbling block for economic development; businesses were struggling and development had been curtailed. He pointed out that the Nenana Basin lay just 50 miles north of Fairbanks. The basin held exciting potential for gas and possibly oil situated adjacent to roads, the rail road and power transmission systems.

Representative Thompson noted that the bill was developed after working with the House Resources Committee, Department of Natural Resources (DNR), Department of Revenue (DOR), Department of Law (DOL), and other communities interested in the concept. The bill was expanded to include drilling in other unexplored/underexplored basins or areas, and expanded to additionally include seismic exploration. He emphasized that the original concept of the bill was preserved, which was to serve Alaskans, not only by providing incentives that could lead to commercialization of hydrocarbons for export, but also to promote exploration for oil and gas resources in frontier basins where there was a possibility for local regional use.

[9:50:48 AM](#)

Representative Thompson observed that ever present in these discussions was how to balance the elements of the bill as a public policy:

- The State's Priority to inspire exploration and development;
- The level of Risk that was reasonable for the state to carry;
- The total financial contribution the state was willing to make; and
- The potential for a return on the state's investment.

JANE PIERSON, STAFF, REPRESENTATIVE THOMPSON, explained the changes between HB 276, Version E and Version G. The major change occurred in section 2, which provided for a 4 percent production tax for the first seven years following the commencement of commercialization or production taxes levied under AS 43.55.011(e), whichever is less, for a production before 2022, should there be a commercial find of oil or gas produced south of 68 degrees North latitude, other than the Cook Inlet.

Ms. Pierson explained that under the draft, section 2 was subject to subsection (j), which referred to Cook Inlet gas or subsection (k), which related to Cook Inlet oil. She explained that new production in Cook Inlet after 2012 and before January 2020 could fall into the four percent tax. She observed that if "kitchen lights" came on board in 2020 there would be two years under the (j) tax rate and then a switch to the four percent tax rate. The change was not

within the original intent of the legislation to fence out the North Slope and Cook Inlet and to offer the tax break in "middle earth". She suggested that the unintentional change could be easily fixed by the committee.

Ms. Pierson noted that federal on shore lands were added after discussions with the Department of Revenue. The tax consequence would be equal to that on private lands. Many of the basins were composed of a combination of federal, private and state lands.

Ms. Pierson observed that conforming amendments relating to the four percent tax were made in Sections 7 and 8. Production tax would be subject to the same benefits and taxes available to other taxes under AS 43.55.011.

[9:55:09 AM](#)

Ms. Pierson discussed Section 6, which included six geologic areas for exploration (map on file). All these areas were identified by Department of Natural Resources as having potential for discovery of hydrocarbons and with some proximity to existing communities struggling with high energy costs.

- Kotzebue and Selawick Basins
- Nenana and Yukon Flats
- Emmonak
- Glannallen and Cooper River area
- Egegik - Northern Alaska Peninsula
- Port Moller - Southern Alaska Peninsula

Ms. Pierson observed that with the addition of these other five areas, the potential cost and risk to the state rose. To address this HB 276 limited the number of exploration wells and seismic exploration eligible for credits and limited the credits. Exploration well credits were limited to four wells in one of the areas identified on the map with no more than two wells in any one area. The tax credit for drilling was 80 percent of the total exploration expenditures for work performed or \$22.5 million, whichever was less. (The credit was 15 percent more than what would currently be available in existing statute, unless the total cost was 20 percent over 22.5 million; then 65 percent was better). The total maximum credit was \$90 million.

Ms. Pierson concluded that the increase was slightly more than the current amount.

Ms. Pierson spoke to seismic credits. Seismic credits were created in the bill to attract new geophysical analysis. The seismic credits could be allotted for up to four projects, with no more than one in any of the areas identified on the map. The credit amount was 75 percent of the total exploration expenditures, or \$7.5 million, whichever is less (i.e. 10 percent more than what was available in existing statute, unless the total was 35 percent over 7.5 million). The total maximum credit that would be available was \$90 million. Seismic projects were subject to the same pre-qualification criteria as drilling. Credits apply to work performed after June 1, 2012 and like other production tax credits in AS 43.55.025, would expire in 2016. The tax credit was also stackable with other credits provided under AS 43.55.025 or AS 43.55.023. It was the intent of the bill that the quick window for these credits would create a frontier basin stampede.

Ms. Pierson explained that Section 6 was created to ensure the state's investment was warranted, and exploration projects were sound, with DNR's input, prequalification criteria were created that must be satisfied before any project commenced. DNR has broad discretion to weigh these factors within 60 days or as soon as practicable before approving or denying exploration well or seismic exploration credits under the bill. The pre-qualification criteria can be found for drilling on page 7, line 21 through page 8, line 2 and for seismic on page 8, lines 24 through page 9, line 2.

Ms. Pierson also key in discussions, was how the state gets a return on its investment. More geological data for state use and public release helped to expand our knowledge of the potential resources in these remote areas. Geological data assisted present and future explorers, and seismic data that could very well attract new investment and development in the state, bringing the potential to increase production, tax revenues and royalties.

Added as qualification for the credits under HB 276 was a requirement that all exploration drilling and seismic data collected must be turned over to the state and made

available for public release within two years of receiving the credit under this bill.

[9:59:11 AM](#)

Ms. Pierson reviewed Section 2. The final consideration that arose was what if an explorer in one of the remote areas of Alaska was successful. The remote frontier areas were difficult to reach, face logistical obstacles, and challenges getting hydrocarbons to market. Yet producers in these areas would pay the same production tax as companies on the North Slope that already has infrastructure and access to markets. She reported that another component was added to address the situation. She read the following:

"For those explorers who reach commercial production in a frontier basin, we gave them a break on their production tax rate of 4 percent or taxes under 43.55.011(e), whichever is less, for seven years following commencement of commercial production, in an area that did not have oil or gas production prior to January 1, 2013. After seven years, the tax rate reverts back to what is in existing statute. The tax rate was crafted only to apply to new production south of 68 degrees latitude for oil and gas not subject to (j) or (k) of this section. This bill gives no breaks on Royalty, corporate income tax, or property taxes. What it does, is give explorers willing to take the risk to explore in these remote areas some predictability for the first seven years of hydrocarbon commercialization. This will assist these companies obtain financing for infrastructure and other costs associated with remote areas."

Ms. Pierson observed that discussions with Doyon indicated problems with financing due to these factors.

Co-Chair Thomas understood a bridge was needed to access the Nenana Basin. Representative Thompson explained that an ice bridge was built and did not know if another bridge would be funded.

Co-Chair Thomas questioned what would occur in the case of a dry hole. Representative Thompson explained that the producer was eligible for a credit in the case of a dry hole conditioned on the due diligence paper work.

Representative Joule announced that he intended to offer an amendment raising the exploration cap from \$22.5 million to \$25 million; the same credit available for Cook Inlet.

Co-Chair Stoltze WITHDREW his OBJECTION, There being NO OBJECTION, work draft 27-LS1193\G was adopted.

Co-Chair Stoltze OPENED public testimony.

10:05:22 AM

ELIZABETH HENSLEY, NANA REGIONAL CORPORATION (via teleconference), testified in support of HB 276. She stressed the high cost of energy in the NANA Region, which averaged \$7.92 per gallon for gas. She believed the legislation would incentivize exploration in the region.

LANCE MILLER, VICE PRESIDENT RESOURCES, NANA REGIONAL CORPORATION (via teleconference), testified in favor of HB 276. He shared that two stratigraphic wells were drilled in the Kotzebue Basin in 1974. The corporation utilized the data to target oil and gas development in the area. The challenge has been to attract risk capital. He felt the legislation would help attract investment. The Kotzebue Basin was untested and untapped, but he felt it held great potential.

JAMES MERY, SENIOR VICE PRESIDENT, LANDS AND NATURAL RESOURCES, DOYON LTD (via teleconference), spoke in support of HB 276. He explained that Doyon LTD was a regional corporation formed under the Alaska Native Claims Settlement Act with over 18,000 shareholders, and was the largest private land owner in Alaska with holdings of over 12.5 million acres in the interior of Alaska. Doyon primarily operated oil field support, tourism, and utility businesses with over 1,500 employees.

Mr. Mery informed the committee that Doyon engaged in exploration activity in the Nenana Basin and Yukon Flats. He spoke to Doyon's business model. He expounded that Doyon had invested money in exploration precipitated by credits offered in the past. The corporation's goal was to attract new investors as the project developed. He emphasized that Doyon was truly a "local" company reflected in its hiring practices and providing opportunities for local communities through the oil field support services. He noted the multiplier effect that successful exploration would bring

encouraged by the credits in HB 276. Seismic exploration demonstrated that there was oil, but the geologic and project investment carried very high risk and proved difficult to attract new investment. The conventional producers were not interested in the area. A different tax regime for the area was necessary. The legislation offered assurance for limited tax exposure during the initial, highest risk phase for capital recovery and additional credits (expected to cost the state approximately \$20 million) on early exploration. Both pieces were essential to attract new capital.

Co-Chair Stoltze stressed the importance of the activities of the smaller Alaskan oil related companies, such as Doyon, to the economy of his district and the state.

[10:16:11 AM](#)

Co-Chair Stoltze CLOSED public testimony.

Representative Neuman referred to Page 2, Section 2 of the committee substitute (CS). He questioned the seven year period [that a four percent tax would be levied on the gross value]. Ms. Pierson answered that seven years was deemed necessary after discussions with Doyon LTD.

Ms. Pierson clarified, in response to a question by Representative Neuman that Section 2 defined that the seven year period began after the point of commercial production. Representative Neuman wondered what the composition of oil and gas was. Ms. Pierson responded that there have been positive indications that both oil and gas existed.

Representative Neuman expressed the desire to maximize the value of the legislation.

[10:20:38 AM](#)

Representative Costello asked what would happen to the seismic information if development did not produce hydrocarbons. Ms. Pierson clarified that the information belonged to the state.

BOB SWENSON, STATE GEOLOGIST, DEPARTMENT OF NATURAL RESOURCES (via teleconference), confirmed that after two years the data would be made public and owned by the state.

[10:21:50 AM](#)

Representative Costello understood that the state separated exploration and production credits in statute. She referenced to language in the bill on Page 13, line 15 that read, "producer" includes "explorer." She asked why the CS contained the language.

SUSAN POLLARD, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW, explained that the language was not a change from current law. The language related to the determination of production tax values. Some producers also perform exploration. She clarified that the language provided for instances when a producer can collect the credit while in exploration mode. She concluded that the situation was provided for in current law and did not change the statute.

[10:24:33 AM](#)

Representative Joule MOVED to ADOPT Amendment 1:

Page 5, Line 14, following "of"
Delete [\$22,500,000] insert "\$25,000,000"

Co-Chair Stoltze OBJECTED for purpose of discussion.

Representative Joule explained that the amendment would raise the level of credits to \$25 million to match the current level allowed in Cook Inlet.

Representative Neuman questioned what statute specified the \$25 million tax credit. Ms. Pierson replied that the provision was contained in AS 43.55.025 (b).

Amendment 1 was HELD in Committee for further consideration.

#

ADJOURNMENT

[10:27:46 AM](#)

The meeting was adjourned at 10:27 AM